

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0447 IT**

**Gross Income Tax—Industrial Processing
For Tax Periods: 1993 through 1995**

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ISSUES

I. Gross Income Tax—Industrial Processing

Authority: IC 6-2.1-2-1, IC 6-2.1-2-2, IC 6-2.1-2-4, IC 6-2.1-2-5;
Jefferson Smurfit v. Indiana Department of State Revenue, 681 N.E.2d 806 (Ind.Tax 1997).

Taxpayer protests proposed assessments of Indiana gross income tax, at the high rate, on a portion of its Indiana gross receipts.

STATEMENT OF FACTS

Taxpayer sells telephone equipment. Taxpayer also provides maintenance contracts to a variety of customers. During the audit period (1993-1995), Taxpayer earned receipts subject to Indiana's gross income tax. Taxpayer characterized these receipts as having been derived from "wholesale sales." As such, taxpayer computed its Indiana gross income tax at the statutory rate of .30%. Audit disagreed. Audit, contended these receipts were derived from taxpayer's provision of services; as such, the receipts should have been taxed, for gross income tax purposes, at the statutory rate of 1.2%. Audit's findings resulted in an increase in taxpayer's Indiana gross income tax. Taxpayer now protests Audit's re-characterization of its receipts and the additional proposed assessments of Indiana gross income tax.

I. Gross Income Tax—Industrial Processing

DISCUSSION

The transactions at issue involve work performed by taxpayer on customer owned tangible personal property (telephone equipment). For purposes of analysis, taxpayer's activities (work) may be classified in one of two ways. In some instances, taxpayer performs material management activities. Taxpayer receives customer (telephone companies) equipment in bulk,

“breaks” the equipment down into individual units, date stamps and inserts warranty cards, packages the equipment and inserts, and then delivers the packaged equipment to customer job sites.

Taxpayer also performs assembly activities. To wit, taxpayer receives partially assembled equipment from its customers. Taxpayer completes assembly according to customer specifications. According to taxpayer, assembly requires taxpayer “to contribute” its own wiring and fasteners to the final product. After assembly, taxpayer packages and then delivers the equipment to customer job sites.

Taxpayer believes the aforementioned activities represent “industrial processing” (a type of wholesale sale”) as defined in IC 6-2.1-2-1(c)(1)(D), explained in 45 IAC 1-1-86, and analyzed by the Indiana Tax Court in Jefferson Smurfit v. Indiana Department of State Revenue, 681 N.E.2d 806 (Ind.Tax 1997).

Taxpayer, in support of its position, directs the Department’s attention to IC 6-2.1-2-1(c)(1)(D)(ii), which has broadened (as amended by P.L.76-1985, SEC.8) the statutory definition of wholesale sales to include:

(D) Receipts from industrial processing or servicing, including:

(i) tire retreading; and

(ii) the enameling and plating of tangible personal property which is owned and is to be sold by the person for whom the servicing or processing is done, either as a complete article or incorporated as a material, or as an integral or component part of tangible personal property produced for sale by such person in the business of manufacturing, assembling, constructing, refining, or processing (emphasis added).

Taxpayer argues its assembly and material management activities “fit” well within the definition of industrial processing (see Jefferson Smurfit v. Indiana Department of State Revenue, 681 N.E.2d 806 (Ind.Tax 1997)). Taxpayer reasons since industrial processing is considered to be a subset of wholesale sales for purposes of computing Indiana’s gross income tax (IC 6-2.1-2-1), all receipts derived from its “industrial processing” activities (i.e., material management and assembly) must, by statute, be taxed at the low rate. (IC 6-2.1-2-4).

Indiana imposes a gross income tax on the "entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana." IC 6-2.1-2-2. The tax is imposed at two rates—the high rate (1.2%), and the low rate (.03%). Receipts from wholesale sales and from selling at retail are taxed at the low rate. IC 6-2.1-2-4. Receipts from service activities, as well as from other business activities, are taxed at the high rate. IC 6-2.1-2-5. The issue now before the Department is whether taxpayer’s contested activities represent industrial processing (receipts taxed at the low rate), or represent service activities (receipts taxed at the high rate).

After reviewing the statutory language and relevant case law, the Department must disagree with taxpayer's conclusions. Specifically, the Department finds that taxpayer's assembly and materials management activities are best characterized as conventional service activities and not those of an industrial processor.

Explicit in the statutory definition of industrial processing is the requirement that taxpayer's customers must be engaged in the business of "manufacturing, assembling, constructing, refining, or processing" (see IC 6-2.1-2-1(c)(1)(D)(ii))—notwithstanding the elimination of the resale requirement by the Tax Court in Jefferson Smurfit.

Additionally, the Department notes that regardless of moniker used—whether taxpayer is engaged in rebuilding, repairing, refurbishing, or even remanufacturing—taxpayer's customers must be engaged in activities listed in the statutory definition. Implicit in the concept of industrial processing is the notion that owners of the processed property (i.e., taxpayer's customers) must be engaged in manufacturing, processing, or similar types of production activities. In this instance, however, taxpayer's customers—telephone companies—are not engaged in production activities. Rather, taxpayer's customers are service providers.

The concept of "wholesale sales" anticipates the production of tangible personal property by one claiming the "wholesale sales" exemption. The language of IC 6-2.1-2(c)(1)(D)(ii)—i.e., "by such person in the business of manufacturing, assembling, constructing, refining, or processing"—is consistent with this notion. The Department, therefore, will not exclude the "manufacturing, assembling, refining, or processing" requirement from its definition, and understanding, of "industrial processing." Consequently, since taxpayer's customers are not engaged in production activities, taxpayer does not qualify for low-rate treatment as an industrial processor. In other words, Audit was correct in its determinations. Accordingly, the receipts derived from taxpayer's provision of assembly and material management services must be taxed at the high rate for purposes of Indiana's gross income tax.

FINDING

Taxpayer's protest is denied.